



House Policy Committee
Congress of the United States
Washington, DC 20515-6549

Policy Statement on Permanent Tax Relief

October 11, 2001

New economic growth legislation should include *permanent* tax relief. On June 7, 2001, President Bush signed the Economic Growth and Tax Relief Reconciliation Act of 2001, which included provisions of six permanent tax relief bills approved by strong bipartisan House majorities.¹ Title IX of the Act, added by the Senate for procedural reasons, provides that no tax relief shall apply after December 31, 2010. Making this year's tax relief permanent is an important step Congress can take *today* to improve long-term economic growth—and a vital step toward a fairer tax system.

Helping Taxpayers by Repealing the Sunset

Retaining the sunset in new tax legislation would cause a multi-billion dollar tax increase that targets those who can least afford it. Under current law, the income tax rate for top earners will rise from 35% to 39.6% on January 1, 2011. Worse, on that same day, the rate paid by lower-income taxpayers would shoot up from 10% to 15%—a 50% tax increase on those who can least afford it. The child tax credit, another provision critical to many lower-income taxpayers, would be halved, from \$1,000 to \$500. The annual contribution limit on IRAs would plunge 60%, from \$5,000 to \$2,000. Parents and children would lose many of the benefits of Coverdell Education Savings Accounts and qualified tuition plans. Incentives for employer provided education assistance would disappear, while the marriage penalty would reappear. And the death tax—phased out by January 1, 2010—would return from the grave, fully re-grown to 2001 rates on January 1, 2011.

1. The six permanent tax relief bills approved by the House were:

- H.R. 3, the Economic Growth and Tax Relief Act of 2001, approved 230-198, March 8, 2001 (reducing five income tax brackets to four: 10%, 15%, 25%, and 33%)
- H.R. 6, the Marriage Penalty and Family Tax Relief Act, approved 282-144, March 29, 2001
- H.R. 8, the Death Tax Elimination Act of 2001, approved 274-154, April 4, 2001
- H.R. 10, the Comprehensive Retirement Security and Pension Reform Act, approved 407-24, May 2, 2001
- H.R. 586, the Fairness for Foster Care Families Act, approved 420-0, May 15, 2001 (treating payments from private and government foster care placement agencies equally)
- H.R. 622, the Hope for Children Act, approved 420-0, May 17, 2001 (expanding the adoption credit)

The Senate combined and amended the bills, which became Public Law 107-16.

The sunset is confusing and frustrating taxpayers *today*. A *New York Times* columnist called the one-year repeal and immediate reinstatement of the death tax the “Throw Momma from the Train Act,” because the only way to create an effective estate plan is to die in 2010—the one and only year when the death tax is completely repealed. Parents planning a child’s education are frustrated by tax law changes in the middle of the process. Provisions meant to improve the economy and taxpayers’ lives are instead complicating personal and government planning.

Taxpayers are enduring needless complexity as they attempt to plan their pensions, their retirement accounts, their small business succession, and their children’s education. On July 26, 2001, the House Policy Committee met with representatives of millions of taxpayers, senior citizens, small business entrepreneurs, employers, tax policy experts, and budget experts concerned about the pernicious effects of the sunset. All found it impossible to establish a logical policy rationale for making the Economic Growth Act temporary. The policy chaos caused by the sunset makes taxpayer planning more difficult and expensive.

Even those who do not pay taxes suffer from the sunset. Small businesses subject to a full-strength death tax in 2011 will be unable to protect the jobs of workers when the founder dies. Sole proprietors worried about succession planning will be reluctant to expand their businesses because unless they die before 2011, marginal rates in excess of 50% will permit the IRS to confiscate more than half of the added value. And all Americans lose because the effects of the sunset include reduced employment and investment, lower wages, limited economic growth, and therefore less federal revenue.

Boosting Economic Growth and Federal Revenue

Congress did not consider the effect of economic growth on revenue in passing this year’s Economic Growth Act. The Staff Director of the Joint Committee on Taxation reported to the Policy Committee that the Joint Committee did not calculate the growth effect of lower tax rates in the Act—notwithstanding the clear intent of Congress manifested in the legislation’s title. Nor did the Joint Committee calculate the reduction in growth caused by making the act temporary, notwithstanding empirical evidence that higher tax rates limit growth and revenue, while lower tax rates boost growth and revenue.

Sunsets impair the growth Congress intends to create with economic growth legislation. Twenty years ago, on a foggy morning at his Santa Barbara ranch, President Ronald Reagan sat at a rustic leather-covered table and signed into law the Economic Recovery Act, which included permanent tax relief reducing the maximum personal income tax rate from 70% to 50% and reducing the tax rate on savings and investment (capital gains) from 50% to 20%. Five years later, he signed legislation lowering rates again, reducing the income tax to just two brackets, 15% and 28%.

Since President Reagan's landmark rate reductions, employment, wages, and productivity soared. Only the July 1990-March 1991 recession—starting about the time that *The New York Times* first warned on July 12, 1990 that Congress and the Administration were considering raising the 28% rate to 31%—interrupted the longest sustained economic boom in American history. In the past two decades, lower tax rates and the resulting economic growth helped kill record inflation. The lower interest rates that followed made homeownership affordable for millions of Americans. Federal tax revenue more than tripled, financing America's Cold War victory over the Soviet Empire and, for good measure, freeing a billion people from totalitarianism.

The U.S. tax rate structure has resulted in tax collections growing far faster than the economy itself. The tax burden on Americans today is five percent higher than when President Reagan signed the Economic Recovery Act into law. Federal revenue is at a record peacetime high, accounting for 21% of the economy, compared to 17.6% in 1993. This flood of revenue and huge surpluses emboldened Congress to spend far in excess of the 1997 budget caps. This large a slice of the economy hasn't been taken by the federal government except for one other year in history.

Today, thanks to record economic and revenue growth, we approach the new challenges of the 21st century with an economy and a nation incomparably stronger than at the outset of World War II. Instead of a decade-long Great Depression, the economic preface to the War on Terrorism is two decades of Great Expansion. Notwithstanding emergency spending, the federal surplus remains larger than anyone predicted when America adopted President Reagan's permanent tax relief. However, economic challenges continue. Social Security must be restructured to ensure its long-term solvency and Medicare requires new resources for prescription drug benefits. Most immediately, a larger tax base will make the War on Terrorism more affordable.

Permanently relieving today's record tax burden will help reverse the slump in industrial production, manufacturing, and trade sales that began last fall. The year 2000 saw 401(k) retirement funds losing money for the first time in their 20-year history. At a bipartisan Congressional economic briefing September 20, economists noted that private sector GDP turned negative in first quarter 2001. Business investment in equipment and software turned negative in fourth quarter 2000. Venture capitalists are investing less than half the amount they did last year to finance new employment and technical innovation and billions of dollars in investment capital have been shifted from high-return to low-return accounts—meaning it is being put to less productive and efficient use. The National Association of Realtors reports that in the one major sector that remained strong well into 2001, housing starts were down 7% from July to August; home sales plunged 50-70% in the days after September 11, and remain down 10% from previous levels; and home inventories are up despite cheaper mortgages.

“From the middle of 2000 to the middle of this year,” *The New York Times* reports, “the economy grew [at] the slowest 12-month pace in nearly 10 years.”

The Federal Reserve is testing the limits of monetary policy. Dr. Lawrence Lindsey, formerly a Federal Reserve Governor and House Congressional Policy Advisory Board member—and today the Assistant to the President for Economic Policy—warned about the danger of relying on monetary policy to offset the heavy fiscal burden on the economy 30 months ago. “Macroeconomic policy is placing an excessive reliance on monetary policy to sustain the current economic expansion,” Dr. Lindsey told the Senate Budget Committee, January 20, 1999. His prescient concern manifested itself in negative market reaction to discount rate cuts on May 15, June 27, and August 21, 2001. Nor could the September 17, 2001, cut stave off record one-day dollar losses.

Monetary policy—less permanent than fiscal policy—is incapable of supporting the economic growth necessary to raise adequate government revenue. As Federal Reserve Chairman Alan Greenspan and Joint Economic Committee Chairman Jim Saxton have noted, Republican success at retiring federal debt will eventually have the ironic consequence of making monetary policy less effective by reducing the flexibility of open market operations. The current edition of *The Economist* reports that “excess capacity and the heavy debt burdens of firms and households,” along with falling confidence, could limit the effect on demand of declining interest rates. These facts make permanent *fiscal* policy for economic growth a vital necessity.

To remain the leader of the free world, the United States must promote economic growth at home through a policy of tax rate moderation. Not only taxpayers, but all Americans and people throughout the world will benefit from permanently moderate tax rates with more jobs, higher wages, lower prices, greater economic opportunity—and more federal revenue.

The Solution

Repealing the current tax relief sunset and avoiding sunsets in the future will help ensure the economic growth necessary to sustain a victory in the War on Terrorism.

Introduced by Reps. Kenny Hulshof (R-MO) and Paul Ryan (R-WI), H.R. 2316 strikes Title IX, the so-called “sunset” provision, from the Economic Growth and Tax Relief Reconciliation Act, making the tax law changes in the Act permanent. The House made its will obvious by making all of its original tax relief legislation permanent. More than 40 Senators have already agreed to sponsor legislation to end the sunset in the Senate. It is the policy of the House Majority to promote the objective of H.R. 2316, ensuring that economic growth and taxpayer fairness become *permanent* features of U.S. law.